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MEMORANDUM

SUBJECT: Economic Costs of Libyan Terrorism to Western Europe

The economic impact of continuing Libyan terrorism on Western Europe is extremely difficult to quantify, but the West Europeans clearly face some potentially serious economic consequences if they do nothing. We believe that the Southern European countries--Portugal, Spain, France, Italy, and Greece--are the most vulnerable to Libyan attacks and stand to lose the most economically, particularly because of the importance of tourism to their economies. Moreover, all of these countries face, or have recently had to cope with, serious balance of payments problems that could be exacerbated by lost tourist receipts; they also all face an increasingly risky environment for foreign investment. If forced to impose additional austerity measures to adjust to lost receipts, some of these governments could also face serious political problems.

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The primary cost of continued terrorism will be a loss of tourism receipts--not only from travellers from the US, but also from Japan, Northern Europe, and elsewhere in the developed world. We calculate that the tourist industry is worth over \$50 billion a year to Western Europe*, and we believe that the total loss in 1986 to Southern Europe will be on the order of \$5-6 billion. For some of these countries, tourism plays a vital role in the

*Austria, Belgium, Denmark, Finland, France, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, United Kingdom, West Germany.

This memorandum was drafted by [] Western Europe Division, Office of European Analysis, with contributions from other economic analysts in the Division. Questions and comments are welcome and may be addressed to [] Chief, West European Division [].

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[redacted]

economy. In both Spain and Greece, for example, tourism accounts for nearly 20 percent of the value of exports, and in Portugal and Italy the figures are about 15 percent and 8 percent respectively. The losses in tourist receipts are particularly dramatic for Italy (at a minimum some \$2 billion) and Spain (at least \$1.5 billion). Even the decline for Greece is significant, because Papandreu has taken a lot of heat politically after being forced to impose a long overdue austerity program last fall to forestall serious debt servicing problems. He cannot afford either the economic or political fallout from even the several hundred million dollar decline in tourist receipts that we foresee this year. [redacted]

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A second, though economically less significant, cost for these economies is increased spending on internal security. Statistics in this area are even harder to nail down [redacted]

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[redacted] most spending on internal security--which is how the item is generally listed in budgets--is not directed solely at terrorism; a policeman guarding an embassy against a suspected terrorist attack one day may be walking a beat the next. Nevertheless, our rough calculations indicate that Southern European countries spend nearly \$4 billion a year on counter-terrorism. Even a small increase in this amount--and we believe that 10 percent would not be out of line given recent events--would pinch already tight budgets. [redacted]

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Beyond the loss of tourism and increased spending on domestic security, other costs are even more difficult to estimate. We believe that continued Libyan terrorism is likely, over the long run, to have a chilling effect on direct foreign investment in Western Europe, particularly by US firms. In 1982, the value of US direct foreign investment in Western Europe totalled more than \$300 billion, with US investment in Southern Europe amounting to over \$60 billion. A decline in US investment would have significant economic implications, especially in France and Italy which depend heavily on US firms for capital and technology. In Greece, where the economy is also suffering from a sharp drop in domestic investment [redacted]

[redacted], the government has campaigned to boost foreign investment. Clearly, the Libyan terrorist threat-- [redacted]

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[redacted] will further erode the confidence of foreign investors. [redacted]

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